

# Consumer Action

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December 21, 2009

Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street & Constitution Ave., N.W.  
Washington, DC 20551

Re: Truth in Lending – Proposed Rule: Regulation Z Part 226; Docket No. R-1367

Dear Members of the Federal Reserve Board:

Consumer Action<sup>1</sup> provides the following comments on the proposed changes to the regulations under the Truth in Lending Act. Consumer Action educates and advocates for many low- to moderate-income consumers who will be affected by your decisions.

The Board's proposal leaves a loophole for home equity line of credit (HELOC) loans. It would allow creditors to make HELOC loans with no advance disclosures. Allowing open-end, home-secured credit to be made with such minimal disclosure requirements will push predatory activity into refinancing – and this is just as dangerous for consumers and the economy as predatory closed-end credit has been.

We also oppose the Board's proposal for a non-inclusive APR for open-end credit. Here the Board proposes to disclose no up front fees or charges in the APR. This is directly opposite to the approach recommended in the closed end proposals. Creating this tremendous gap in meaningful regulation between closed and open-end, home-secured credit will make it impossible for consumers to compare the products.

Changes for open-end credit will not only enable HELOC lending to become much more abusive, but will also undermine the Board's innovative proposals for closed-end credit – because the abuses will simply migrate to the less regulated open-end credit market. The Board's HELOC proposal requires major revisions.

The Board must write strong rules for the subprime HELOC market where abuses are most likely to occur. The Board bases its flawed approach for HELOC changes on the mistaken idea that HELOC borrowers seek out HELOCs. Typically, they do not. Borrowers in the subprime market are most often provided HELOCs as part of 80-20

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<sup>1</sup> Consumer Action ([www.consumer-action.org](http://www.consumer-action.org)) is a national non-profit education and advocacy organization that has served consumers since 1971. Consumer Action serves consumers nationwide by advancing consumer rights in the fields of credit, banking, housing, privacy, insurance and utilities. Consumer Action offers many free services to consumers and communities, including an assistance/referral hotline. Consumer Action develops free consumer education modules, training, and multi-lingual materials for its network of more than 8,000 community based organizations. Consumer Action's publications are offered in Chinese, English, Korean, Spanish and Vietnamese.

financing deals. The lender finances 80% of the obligation with a closed-end mortgage, and the remaining 20% with a HELOC. This may be a home purchase or a refinance, but the bottom line is that the borrower is highly leveraged, with no equity cushion. The borrower rarely understands the terms of the deal before closing, or even that there are two loans, and is never made aware that one of the loans is a HELOC. The HELOC is a line of credit in name only—when used in place of a down payment the entire amount available is typically drawn down at closing.

Additionally, the Board treats HELOCs as an alternate form of a credit card, not a mortgage, which it is because it is secured by the home. Again, this view ignores the subprime market, where HELOCs are primarily sold as part of a mortgage transaction. They are sold along with closed-end mortgages in 80-20 transactions. If you allow HELOC lenders to provide an APR that does not include fees, you will be blessing a regime to make HELOC APRs appear lower than the APRs for comparable closed-end mortgages, giving consumers the false impression that the HELOC rate is lower than its actual cost.

We would like to point out key problems with the proposal:

- Brokers will be able to steer borrowers into HELOCs and provide the terms of the HELOC only at closing.
- HELOCs that are used to purchase a home will not be rescindable, so home purchasers who sign a fully-drawn HELOC at closing will have no ability to get out of it.
- Brokers will be able to mislead borrowers by selling HELOCs as cheaper than closed-end loans by showing borrowers the HELOC APR, which will look lower only because the two APRs are defined differently.
- Lenders could even offer a consumer a plain-vanilla fixed-rate, closed-end loan to purchase a home, and then switch the borrower to a subprime HELOC at closing.
- Bad lending will migrate to HELOCs, undermining the true reforms that the Board has proposed for closed-end lending.

We believe it is a grave misstep to provide the borrower with their first and only disclosures about the terms of the HELOC at closing.

Please recognize the dangers of home-secured, open-end credit. Your proposal on open-end credit reduces protections for consumers. Instead, we recommend you mandate disclosures equivalent to closed-end credit, and include substantive protections such as requiring creditors to evaluate the borrower's ability to pay on all home-secured credit.

Sincerely,



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Consumer Action



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Deputy Director, National Priorities  
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